Edited by
Wouter H. Muller
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Anti-Money Laundering: International Law and Practice

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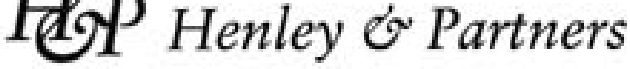

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Acknowledgements

This publication arose from the idea and need for a really first-rate, up-to-date and useful handbook on Anti-Money Laundering Laws and Regulations, simply because nothing of this kind had been attempted before. The publishers, *John Wiley & Sons*, concurred with this idea. They and the editors are now pleased to present the result to interested readers.

A great deal of specialist knowledge, work and effort has gone into this project, and it has certainly proved worthwhile. As an expression of its overall concept, this volume can unquestionably be seen as a pioneering achievement. The authors, editors and publishers hope that the users of this handbook share this viewpoint as well as their enthusiasm for the project.

At this point we would like to express our sincere thanks to all those who have contributed to and supported this book. Special thanks are due to our colleagues at *Henley & Partners*, in particular to *Rebecca van der Burg*. Furthermore, we also thank all the authors, the publishers as well as the *Society of Trust and Estate Practitioners*, the *International Compliance Association* and *Henley & Partners.* Thanks to their valuable support, they have also contributed to the successful publication of this handbook.

Zurich and London, October 2006

Wouter H. Muller
Christian H. Kälin
John G. Goldsworth

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About this book

This book presents thorough yet practical information on the most important issues concerning international anti-money laundering laws and regulations. It is designed as a guide for **lawyers, bankers, regulators, business advisors, private-client advisors**, **family offices** and others who have to deal with the ever-increasing anti-money laundering maze. The use of concise and precise language reflects its character as a handbook and reference source. In particular, the authors have endeavored to express the terms and concepts involved as straightforwardly as possible in order to make them easily accessible, especially to those without a legal background. Footnotes are mostly avoided for the sake of clarity.

The book is divided up into many different **chapters**. The general chapters at the beginning cover broader issues readers should know about, whereas the various country chapters cover the most important areas that are relevant in practice for each jurisdiction. The individual chapters aim to explain the details without however being too technical.

The individual chapters of this book have been written by different co-authors. **Each of the authors is responsible for the contents of his/her chapter only** and it does not imply that a co-author or the organization he or she is affiliated with agrees with the contents of chapters contributed by other co-authors or their organizations.

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Any **comments and suggestions, praise or criticism** will be gratefully received. If you as the reader feel that a particular topic or address should be removed from or added to this volume, please let us know.

By all means write to the editors via e-mail at zuerich@henleyglobal.com or by conventional mail at the following address: Wouter H. Muller, *Henley & Partners*, Kirchgasse 22, 8024 Zurich, Switzerland. The publishers will be happy to recompense useful information with a product from their current program.

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He obtained a doctorate in civil law at the Law School of the University of Groningen in 1971 and then worked for 10 years as a solicitor in the Netherlands, specializing in family, real estate, corporate and tax law. In 1981 he joined Pierson, Heldring & Pierson N.V., a Dutch merchant bank in Amsterdam. For PHP he worked first in Luxembourg at their joint venture with Sal. Oppenheim & Cie. as director of their Luxembourg trust company. In 1987 he was appointed managing director of the PHP trust company in Curaçao (Netherlands Antilles) and in 1991 as director of the private bank in Luxembourg, being responsible a.o. the trust operations. In 1996, after the merger of PHP with Bank Mees & Hope into MeesPierson, Mr Muller went to Switzerland as director of the private bank, responsible for the Zurich office and for sales and marketing. Later he was also appointed as managing director of the trust office in Zug.

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He also specializes in real-estate structuring and real-estate investments and is a member of the panel of judges for the Bentley International Property Awards. He is the editor and one of the co-authors of the International Real Estate Handbook, a standard work in the field.

John G. Goldsworth is a Barrister at Gray's Inn in London as well as the Editor of Trusts & Trustees, the leading independent professional journal in this field. An expert in international trust law and practice, he holds the degrees of LLB (Hons) from the University of London, and LLM in International Business Law from the University of Exeter and was called to the Bar at the Middle Temple in 1965.

Mr Goldsworth acts as 'of counsel' to a US law practice where international structures are recommended to international investors, and he is in Chambers at 8 Gray's Inn Square, London

where, as a founder member of the Offshore Development Group within these Chambers, he advises governments, institutions and companies on the proper use and development of offshore financial activities and the development of legislation for inward and outward investment including company law, trusts, tax law, and financial law. This activity has included advising the governments of Iceland, Mauritius, Anguilla, the Seychelles and others. In his capacity as advisor to the Seychelles Ministry of Finance, his activities included attending the Commonwealth Finance Ministers Conference, sessions of the OECD and negotiating with international bodies such as the FATF and the UN. In addition many less formal contacts have existed with other countries on international law matters.

Mr Goldsworth is a member of several professional organizations and was chairman of a sub-committee of the International Bar Association on Transnational Litigation, 1985–1987. He is frequently a chairman and lecturer at professional conferences, currently including the most important annual conference on Trust Law, the International Trusts Congress in London. He is also a lecturer for the Certificate and Diploma Course of the Society of Trusts and Estate Practitioners (Guernsey, Monaco and Singapore).

Foreword

I was very pleased when I was approached to contribute to a work of a truly multinational character such as this handbook. Knowledge about technical matters and techniques to deal with money laundering is very important. However, I believe that among all the technical discussions about money laundering we often lose sight of the fact that combating money laundering is about combating large-scale criminality, protecting the integrity of financial systems and, most importantly, promoting transparency and good governance.

A handbook such as this, drawing together the combined wisdom and knowledge of contributors from a diverse range of jurisdictions and backgrounds, is therefore a major step to the promotion of awareness of the fundamental purpose of the fight against money laundering.

I believe that a work of this nature will be invaluable to practitioners and policy makers alike in all parts of the world.

It is common knowledge that one of the primary reasons for people to engage in criminal activity, especially at an organized level, is to make money. However, criminals are not only interested in making money but also in enjoying their criminal proceeds and reinvesting them in future criminal activity. They need to do this without drawing attention to the illegal sources of their wealth. Criminals must therefore have access to financial resources in order to survive and grow. In this way the scourge of money laundering works to perpetuate all manner of criminal activities of the most serious nature – activities such as drug distribution, terrorism, corruption and trafficking in women and children. It is with this in mind that we should consider the impact of money laundering on our societies.

The motivation for criminals to engage the financial sector is not the same as that of legitimate business and they do not share the same objectives. As a result illicit proceeds do not necessarily behave in accordance with normal market principles when they are laundered. Illicit proceeds contribute minimally to economic growth. The consequences of money laundering include greater risks to the soundness of financial institutions and contamination of legal financial transactions, while legitimate business gets displaced to more secure jurisdictions.

Continued laundering of criminal proceeds gives criminals financial power which they can use to further social disintegration, to undermine government structures and to violate community cohesion. It is painful to realize the degree of devastation of lives and communities that criminals cause when they wield this sort of power.

The reaction of the international community was slow but certain. Countries first developed measures to combat money laundering in the 1980s, which led to the formation of the Financial Action Task Force in 1989 – the most coherent response by the international community to the challenge of money laundering. The FATF is generally regarded as being at the forefront in giving shape and direction to the policies and measures aimed at regulating and controlling money laundering. Today, more than 150 countries have committed themselves to implementing the measures to combat money laundering recommended by the FATF.

Measures such as those recommended by the FATF are necessary to protect the integrity of a country's financial sector, to ensure that proceeds of criminal behaviour are detected and confiscated, and that criminals are prosecuted and convicted. If we do this, measures to combat money laundering help reinforce the rule of law, and are important for an effective legal system, a business friendly environment and long-term economic and financial development. These

measures when fully and effectively implemented, are an integral part of good governance, sound financial management and an important part of the fight against all forms of criminal activity that threaten our communities: local, national and international.

Practitioners in this area now have a practical handbook from different jurisdictions at hand. We should therefore be grateful to the editors for this initiative, which I heartily support.

Professor Kader Asmal, M.P.
President, Financial Action Task Force, 2005–2006

Anti-Money Laundering – A short history

A personal view from one of the editors

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Contents – Anti-money Laundering – A short history

1 Introduction

Money laundering is probably as old as money itself. In the past, however, nobody looked at it as a crime as such. It was more the underlying crime that was looked at than what was done with the proceeds of that crime.

It is undeniable that during the **Prohibition** period in the USA (1920 – 1933) enormous amounts of money must have been laundered. It is interesting to note that when Al Capone, the most notorious gangster in the *USA* in that time, was indicted for the first time in 1931, it was neither on charges of violating the ***Volstead Act*** that created the Prohibition (banning a.o. the transportation and sale of beverages with more than 0.5% alcohol) nor on charges of the numerous murders committed by him and his gang. It was on charges of evading Federal Taxes during the tax years 1925 – 1929.[1] At the time this was the closest a US Attorney came to indict someone for money laundering. It is also interesting to note here that, where police forces with guns endlessly chased these gangs without success, it was the people behind desks without guns who were eventually successful in getting these gangsters indicted and charged.

After Al Capone was sent away for 11 years it was clear to the mob that other ways had to be found to remain successful in their 'business'. Since **tax evasion** had proved to be a successful way to arrest and convict these 'business men' a way had to be found to mislead the tax authorities. 'Money that could not be found could not be taxed', so ways had to be found to safely put that money out of sight.

2 Bank secrecy

It is a coincidence that *Switzerland*, by strengthening its **bank secrecy** laws in the early 1930s, more with the aim of helping people hide away money in fear of the Nazi regime than for other reasons, came into the view of people who wanted to hide money for all kinds of legitimate and less legitimate reasons at that time. Not that *Switzerland* was alone in having bank secrecy rules, but it already had for a long time a well-established name for being discreet. Tax evasion not being a crime in Switzerland at the time, money could be safely put away without too many questions being asked. Only two directors of the bank in question had to know the identity of the client. For all others it was a numbered account or an account with a certain agreed code. Putting away money, however, was one thing, but using this money in a way that it could help to make 'business' grow was another.

3 Offshore

It was already in the late 19th century that the 'offshore' world was created. New Jersey was the first to offer companies, established in that state and doing business in another state, to pay the lower New Jersey tax rate. The state of Delaware was quick to follow and is to date still one of the most important offshore centers in the world and certainly the most important within the USA.

The Bahamas, next door to the USA, became an important offshore center when it was detected by the 'gambling industry' and international trading companies. Goods were traded from one

[1] Later that same year he and his gang were indicted on over 5000 violations of the Volstead Act.

country to another and 'on paper' via a Bahamian company who had to pay little or no taxes at all. When this trading business started to grow the need for offshore banks was evident. Well-known and reputable banks settled on the Bahamas to facilitate this business. Also, wealthy individuals were in a position to establish offshore trusts to safeguard their wealth for others than their designated beneficiaries.

World War II, however, was the factor that initiated the big growth for the 'financial offshore industry'. International companies like Shell and Philips moved their corporate seats to Curaçao in ***the Netherlands Antilles*** to be safe from the invading Third Reich in Europe. Based on this occurrence *the Netherlands Antilles* adopted the Law Seat Transfer in order to accommodate companies to transfer their seats in case of threat of war. Certainly during the period of the Cold War lots of companies included these kinds of safety measures into their company articles.

4 Euro dollars and offshore lending

The 'big boom' for the financial offshore industry in the Netherlands Antilles started in the late 1960s a.o. with the creation of the so-called 'Euro dollars'.

4.1 Euro dollars

Euro dollars already existed for a long time. With the implementation of the **Marshall Plan** after WW-II **US dollars** started to flow into *Europe*. As the USA became the biggest export market for Europe after the rebuilding of its industry, even more dollars flowed into Europe and so enormous amounts of US dollars were held in custody by non-US banks in *Europe*. The *Soviet Union* at that time also held US dollars, however in US banks, secured by Certificates of Deposit. After the invasion of *Hungary* in 1956, when the Cold War started to become really grim, the *Soviet Union* feared that the USA might freeze their US dollar deposits held in US banks. It was then that a British bank came up with the solution. The Soviets could place their US dollar deposits with the British bank and the British bank would then deposit its US dollars with a US bank. The USA could never freeze these dollars now that they no longer belonged to the Soviets but to the British bank. It is said that this transaction was the first to create the so-called 'Euro dollars'.

4.2 Euro dollar bond loans

Later, also because of the historically lower US interest rate, it became attractive for companies in Europe, used to much higher interest rates and in need of extra capital, to borrow on the US Capital Market. Making use of the immense treaty network of *the Netherlands*, Dutch Finance Companies, owned by non-US international corporations, issued US dollar bond loans through a Netherlands Antilles' subsidiary on the US market. Under the applicable treaties interest could be paid free from the usual 30% withholding tax. For the institutional investors this was a lucrative investment tool, for the internationally operating companies an interesting tool to get access to the vast US dollar Capital Market. In the heydays of this money-lending scheme, billions of US dollars, or better Euro dollars, floated through this money-lending circuit.

5 Closing the loophole

However, as it mostly goes with these inventive financial products, this mechanism of money lending was misused by others than for which the mechanism was initially developed. Less

honorable institutions more and more started to use – or rather misuse – this finance vehicle and the whole scheme ended when in 1987 the *USA* abolished the treaty with the Netherlands Antilles.[2] Together with ***FIRPTA***[3] in the early 80s these were the kind of measures taken by the US Government to make the investment of undeclared and illegally obtained money more difficult.

6 Tax avoidance and tax evasion

Still, these measures were aimed more at making tax evasion less attractive if not impossible. Whereas tax avoidance was still acceptable, tax evasion was considered by many states as an illegal act and therefore punishable under a Penal or Criminal Code. However, the difference between tax avoidance and tax evasion was – and still is – a thin line. 'The difference between tax avoidance and tax evasion is the thickness of a prison wall.' It is not clear from whom this saying originates and the meaning is also not very clear. Most probably it indicates that evasion is illegal and avoidance is not, but there is no moral difference.

The IFA,[4] on the occasion of its Annual Meeting in Venice in 1983, dedicated one of its seminars to the difference between tax avoidance and tax evasion. As was to be expected, no general conclusion was reached. I remember well that in the discussion of this seminar a South American delegate ventured the – by all delegated already long expected – statement that the difference between avoidance and evasion could not be generally defined because it could very well be possible that what was considered to be evasion in Europe or the USA was to be considered avoidance in South America!

7 Public scandals around the misuse of the financial (offshore) system

It was the scandals around Bernie Cornfield's ***IOS***, having its headquarters in Geneva before the Swiss authorities withdrew his license and forced him to go completely offshore, and at one time having more than 15 000 salesmen working over the world in more than 100 countries, that made the general public aware of the existence of the financial offshore world and the possible misuse.

Later the collapses of **Banco Abrosiano** in Italy in 1982 and the ***BCCI***,[5] worldwide represented but investigated and eventually closed by a joint action of the British and Luxembourg regulators and in the USA by the Manhattan District Attorney Robert Morgenthau in 1991, made it clear that even fully licensed **banks**, supervised by well-respected national institutions, were used for other ends than the normal day-to-day banking transactions.

In the USA the scandal of the collapse of **S&L's**,[6] that after deregulation in 1982 left the US taxpayer with an unpaid savings and loan repair bill of over US$200 billion by the end of 1988, as well as the bankruptcy on 13 February 1990 of Drexel Burnham, demonstrated that, in spite of Federal supervision, banks could easily be used for other non-reputable ends. The fact that these institutions were largely used by the men in the street disguised the real aim of these institutions. The worldwide network, however, made it difficult if not almost impossible for the supervisor to

[2] A grandfathering clause was however agreed to for bond loans that had not yet matured.
[3] Foreign Investment in Real Estate Property Act.
[4] International Fiscal Association.
[5] Bank of Credit and Commerce International.
[6] Savings and Loans Banks.

detect the misuse and the criminal background. All these institutions eventually turned out to be the means to an end: money laundering.

IOS was used by Meyer Lanski for laundering his 'silver dollars' from the gambling tables before he purchased his own bank, Miami National. Banco Ambrisiano maintained a scheme of offshore companies to launder money for the Mafia and the P2 Lodge and *BCCI* was used by big-time arms traders, the one time Panamanian dictator Manuel Noriega and the **Medellín cartel**.

8 The international fight against money laundering

The ever-increasing production, trade and subsequent use of narcotics have led to an ever-increasing stream of drugs money. The paradox here is that the constantly improving automation of international money transfers makes it easier for criminals to transfer money on all sides of the world from one account to another in a split second, but at the same time makes it easier for the regulators to check and monitor international money movements and detect unusual patterns of money movements.

8.1 The FATF

8.1.1 Forty recommendations

Recognizing the immense thread of these developments the G7 at its summit in 1987 decided that international action was needed to combat the increasing misuse of the worldwide financial system by criminals laundering drugs money. It was then that it was decided to establish an intergovernmental body to set worldwide standards to fight money laundering, the 'Financial Action Task Force' (***FATF***). The FATF was quick in setting global **AML Standards** by issuing its **Forty Recommendations** in 1990.

8.1.2 NCCT

It proved to be a powerful tool to convince countries to change their legislation in such a way that it adhered to these Recommendations. Countries that refused to adopt these Recommendations were put on a list, sometimes referred to as the 'Black List',[7] of 'Non Cooperative Countries and Territories' (***NCCT***). To be on this list turned out to be negative for the particular country and in October 2006 Myanmar (Burma) was the last country to be removed from the list.

8.1.3 Nine special recommendations

After the tragic events of **11 September 2001** it was evident that the world was no longer the same. A new phenomenon, **terrorism**, although already existing for a long time,[8] became the new focus and the Axes of Evil were a fact. Nobody new where a new deed of terror was going to take place and the attacks in *Madrid* and *London* proved that it could be anywhere and anytime.

[7] The OECD Tax Competition Group also uses a blacklist which is, however, more related to tax matters than to AML/CFT.

[8] For example, the RAF in Germany in the late 1960s and 1970s, the IRA in Northern Ireland and England and the ETA in Spanish Basque territory.

The *FATF* was very fast in responding to the events of 9/11 and already in October 2001 its mandate was extended to deal with all issues related to terrorist financing (***CFT***). In that same month the *FATF* adopted eight **Special Recommendations** on terrorist financing, complementary to the already existing 40 Recommendations and a ninth Special Recommendation was added in October 2004. In the meantime, as a result of changed and more sophisticated money laundering techniques, the 40 Recommendations were amended twice, in 1996 and 2003, to become more effective by reflecting those changes.

8.2 Response of the world

As a result the whole financial world has changed in general and the financial offshore world in particular. Whereas the 1980s were often referred to as the decennium of 'Total Greed' and the 1990s as the decennium of 'Cleaning Up',[9] the new millennium has become the time to really clean up the financial world.

Even the US banking world, after it first vehemently opposed **due diligence** and ***KYC*** rules, which were already common practice in the European banking world, now had to implement these very strict rules after the adoption of the ***USA Patriot Act***.[10]

The rest of the world were now confronted with the ***QI system,***[11] by which every account holder had to be identified when investing in US securities in order to establish whether or not the (ultimate) beneficial owner of that account, when claiming the benefits under a double tax treaty, was entitled to those benefits and not misusing the applicable treaty.

8.3 FIUs

Countries are more and more encouraged to join the FATF, which now consists of 31 countries and governments, and to become compliant with the 40 + 9 Recommendations. It became apparent that financial institutions are the source of information with regard to unusual or suspicious financial transactions. Obligations under national law, based on the FATF Recommendations, forces financial institutions to report these transactions to their Money Laundering Reporting Offices. These offices are mostly referred to as **Financial Intelligence Units** (***FIUs***) or sometimes Financial Investigation Units. Exchange of information between member countries of these confidential – financial – data became an important tool to effectively combat money laundering and terrorist financing. In order to be able to make effective use of this information, but, on the other hand, to protect its confidentiality, it became apparent that the exchange of this information had to be institutionalized.

8.4 The Egmont Group

In the early 1990s an informal global network of *FIUs* came into being. In June 1995, during a meeting of representatives of these *FIUs* in the Egmont – Arenberg Palace in Brussels, the **Egmont**

[9] It was in those years that people like Ivan Boesky, Dennis Levine and Michael Milken were convicted. The plea bargains of Boesky and Milken eventually led to the demise of Drexel Burnham.

[10] The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Public Law 107-56, signed by President George Bush on 26 October 2001.

[11] Under the QI system every Qualified (financial) Intermediary has the obligation to identify the owner of an account through which investments in US securities are made. When the (beneficial) owner of that account is a US citizen or holder of a US Green Card, the QI has to withhold 30% Dividend c.q. Interest Withholding Tax on dividends c.q. interest paid out on US securities. Under the QI Agreement the QI is obliged to inform the US IRS about the identity of the account holder when requested.

Group was born, an informal group of government agencies that all had sensitive confidential information at their disposal. The Egmont Group defined as its common goal 'To provide a forum to enhance mutual cooperation and to share information that has utility in detecting and combating money laundering and terrorist financing'. The Legal Working Group of the Egmont Group, on the basis of the evaluation of answers on questionnaires distributed among members of the group, devised a definition of a *FIU*, which was approved by the members in 1996 and later amended in 2004 to reflect the growing emphasis on terrorist financing. At the moment of writing this chapter 101 *FIUs* around the world now meet the Egmont definition!

8.5 FATF Mutual Evaluation Reports

In the meantime the FATF conducted mutual evaluations of member countries in order to monitor the implementation of the 40 Recommendations and to assess the effectiveness of the AML systems in its member countries.

In January 2005 the FATF started a third round of mutual evaluations. This round, however, focused more than in the past on CFT now that the nine Special Recommendations and the AML/CFT Methodology 2004 were implemented. Evaluations are conducted by a team of specialists from the financial, legal and law enforcement areas from a member country and the FATF Secretariat. The eventual findings of the assessment team are compiled in a **Mutual Evaluation Report** to be presented to and discussed during the Plenary Meeting of the FATF. Members have agreed that the full evaluation reports will be made public and a summary be published on the FATF's website.[12]

The fact that these reports are shared with FATF-style Regional Bodies (***FSRBs***), the Offshore Group of Banking Supervisors (***OGBS***), the ***IMF*** and the **World Bank** make it a very strong tool to encourage countries not only to implement the Recommendations in their legislation, but also to make sure that the necessary actions are taken to really combat money laundering and terrorist financing effectively.

9 Private initiatives

It is evident that a lot of effort is given on a supranational level, international and national level to fight money laundering and terrorist financing. It is also evident that, on the basis of these initiatives, private initiatives became more and more important in order to keep their profession clean. The **Basel Committee on Banking Supervision** (***BCBS***), for instance, is a good example of such initiatives.

In October 2001 it set the Standards for Customer Due Diligence for Banks. In February 2003 it adopted and published, as an attachment to these Standards, General Guidelines to Account Opening and Customer Identification. Banks, established in member countries, generally adopted these standards and guidelines. In June 2003 the BCBS, in a joint exercise with the International Association of Insurance Supervisors (***IAIS***) and the International Organisation of Securities

[12] www.fatf-gafi.org: In 2005 and 2006 the following countries were evaluated: Australia, Belgium, Denmark, Ireland, Italy, Norway, Spain, Sweden, Switzerland and the USA.